

Board Diversification Strategy: Realizing Competitive Advantage and Shareowner Value

Introduction

The topic of board diversification was until recently an exercise in corporate social responsibility, ethics, morality, and in some parts of the world such as Norway, regulatory compliance. Today, this discussion has moved well beyond the moral imperative to a new discussion. Core business concepts such as competitive advantage, organizational performance, creativity, innovation and shareowner value are the new talking points linked to a diverse slate of board directors.

From a conceptual perspective, the diversification of talent at the top of the company lends itself to a solid risk management strategy. Basic portfolio allocation theory suggests that a more diverse basket of equities tends to lead to lower levels of equity risk. However, in the US, the rapid ascension of women and ethnic minorities in senior management, entrepreneurship and senior policymaking positions has led to a new pool of potential candidates for boards in publicly traded companies.

Furthermore, the rapid growth in purchasing power of US ethnic minorities in particular has resulted in growth and market opportunities in ways that other mature nations are not accustomed. This convergence of high quality diverse management talent and fast growing diverse customers (businesses and consumers) has resulted in CalPERS funding of this white paper to determine the economic impact of Board Diversification on publicly traded companies.

While board diversification as a business topic is at a nascent stage, the questions surrounding its impact will continue to be a topic for further research and evaluation in the US and internationally for years to come.



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Executive Summary

This whitepaper offers critical knowledge around opportunities to improve board of governance effectiveness and shareowner value. The opening section examines board diversity from a gender and ethnic minority representation perspective, but expands the traditional diversity definition to include diversity of board skills. In this report, a diverse individual is defined as being female, African American, Asian, and/or Hispanic. While this is a standard definition of diversity, aligned with the US Census and the EEOC, this report will move beyond visual diversity and also consider the diverse skills that board members bring into the boardroom, regardless of race and gender. Corporate boards decide the mix of director attributes, experiences, diverse perspectives and skill sets that are most appropriate for the company. Core attributes of board directors should address accounting or finance, international markets, business or management experience, industry knowledge, customer-base experience or perspective, crisis response, leadership and strategic planning as well as address historically underrepresented groups on the board, including women and minorities. The coming together of visual diversity with skills diversity leads to a greater diversity of perspective and thought.

Key whitepaper learnings include the following:

1. A gap still remains between ethnic minority representation on corporate boards in Fortune 100 companies versus the general US population.
2. While women comprise slightly more than half of the US population, they hold a mere 17% of the positions on corporate boards at Fortune 100 companies. Research suggests that companies with more diverse boards, especially gender based diversification, have higher performance and key financial metrics such as: Return on Equity, Return on Sales and Return on Invested Capital.
3. A selected group of companies with a high representation of diverse board seats (ranging from General Electric to Honeywell) exceeded the average returns of the Dow Jones and NASDAQ Indices over a 5 year period.
4. Each of the selected group of companies with a high representation of diverse board seats also have a Head of Diversity executive responsible for managing the company's diversity initiative.
5. The Business Case for Diversity has evolved to a proven Diversity Return on Investment (DROI) model that can be implemented across industries and on a global scale.
6. Companies that have non-diverse boards or have not integrated a diversity ROI model within their current diversity initiative may be at a clear competitive disadvantage and may be underperforming in terms of shareowner value.

The increasing diversity of corporate employees, consumers, suppliers and communities around the globe has resulted in the emergence of new pools of employee, management and board talent. While diversity linked to gender and ethnic minority status continues as the focal point of board diversification and shareowner value, diversity of board skills will have a major impact on board of governance effectiveness. Corporate Boards can leverage the insights of this whitepaper by following these suggested steps:

1. Place board diversity as an agenda item at a future board meeting.
2. Use best practices from this whitepaper as a road map for both board diversity and diversity return on investment.
3. Tap into key resources as listed in the Implementing Diversity Best Practices section.
4. Embed a Diversity ROI strategy in your organization with objectives, deliverables, accountability, and metrics. Corporate boards that embrace this approach will be strategically positioned to realize untapped future value.

I. The State of Board Diversity in the Fortune 100

Ethnic Minority Representation

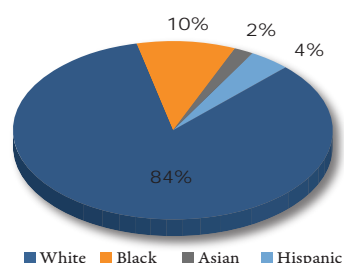
Diversity has become an inescapable fact of life. It is evident in the workplace, among customers, and in our communities. Globalization adds even more layers of diversity as the world becomes interconnected across continents and oceans. Not surprisingly, more companies are finding that having a diverse board of directors is a critically important component of a successful business strategy.

In this report, a diverse individual is defined as being female, African American, Asian, and/or Hispanic. While this is the standard definition of diversity that is in line with the US Census and the EEOC, this report will move beyond visual diversity and also consider the diverse skills that board members bring into the boardroom, regardless of race and gender. The coming together of visual diversity with skills diversity leads to a greater diversity of perspective and thought.

Earlier this year, the CalPERS Board reaffirmed the importance of diversity on corporate boards by expanding corporate governance guidelines for portfolio companies. The new guidelines have been amended into the System's Global Principles of Accountable Corporate Governance, which are used by CalPERS to vote proxies, engage management and boards of publicly traded companies, and implement strategic initiatives.

While many companies are beginning to make great strides in creating a more diverse and inclusive workforce, a great deal of progress still remains in terms of creating a more diverse and inclusive workforce. As shown in the charts below, a gap still remains between ethnic minority representation on corporate boards in Fortune 100 companies versus the general US population.

FIGURE A: Percentage of Board Seats by Ethnicity

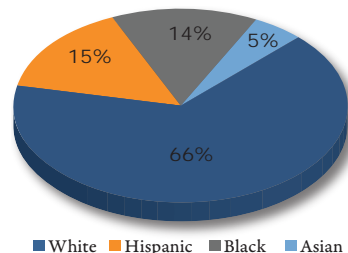


Number of Board Seats by Ethnicity

| | | | |
|-----------|-------|--------|-----|
| White: | 1,031 | Black: | 119 |
| Hispanic: | 49 | Asian: | 20 |

Source: "Women and Minorities on Fortune 100 Boards," The Alliance for Board Diversity, 2008

FIGURE B: Percentage of US Population by Ethnicity



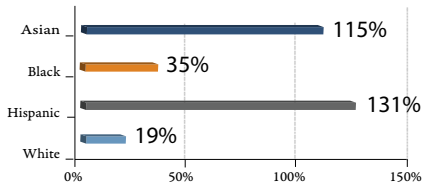
Number of People in US Population by Ethnicity

| | | | |
|-----------|-------------|--------|------------|
| White: | 198,744,494 | Black: | 40,240,898 |
| Hispanic: | 44,321,038 | Asian: | 14,907,198 |

Source: US Census 2006 and Virtcom Consulting analytics

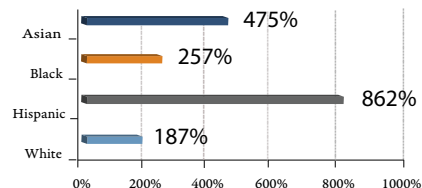
Forward-looking companies must be especially mindful of the massive demographic changes that are already taking place. The following charts show the current projections in population growth and buying power for the major ethnic groups in the US between 1990 and 2012.

FIGURE C: Growth in Population: 1990-2012



Source: Selig Center for Economic Growth, The University of Georgia, 2007 and Virtcom Consulting analytics

FIGURE D: Growth in Buying Power: 1990-2012



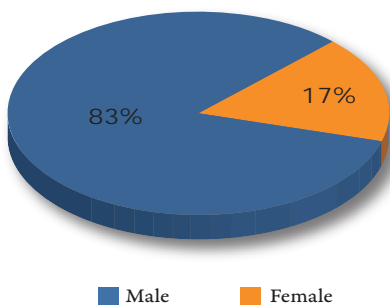
Source: Selig Center for Economic Growth, The University of Georgia, 2007

This data, drawn from the Center for Economic Growth at the University of Georgia, shows that ethnic minorities are expected to outpace Caucasians significantly in population size over the given time period. Perhaps more importantly, the buying power for each of these minority groups is projected to increase even more dramatically as well. In the case of Asians and Hispanics, these two groups will have a very disproportionate increase in buying power, even relative to their expected population growth rates. Companies which are ignorant of these trends or simply unprepared for them may find themselves becoming increasingly less relevant in the marketplace.

Gender Representation

In terms of gender representation, corporate boards are still quite clearly behind.

FIGURE E: Percentage of Board Seats by Gender

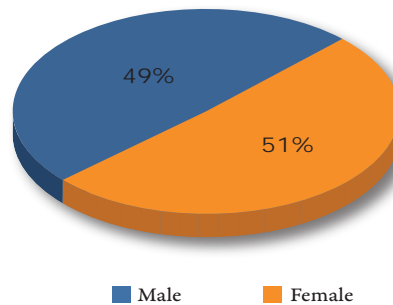


Number of Board Seats by Gender

| | | | |
|-------|-------|---------|-----|
| Male: | 1,011 | Female: | 208 |
|-------|-------|---------|-----|

Source: "Women and Minorities on Fortune 100 Boards," The Alliance for Board Diversity, 2008

FIGURE F: Percentage of People in US Population by Gender



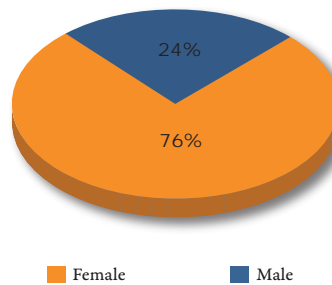
Number of People in the US Population by Gender

| | | | |
|-------|-------------|---------|-------------|
| Male: | 148,639,222 | Female: | 152,981,937 |
|-------|-------------|---------|-------------|

Source: US Census 2006

While women comprise slightly more than half of the US population, they hold a mere 17% of the positions on corporate boards at Fortune 100 companies. This disparity is even more concerning in light of the fact that women control a significantly disproportionate share of consumer purchasing power in the US, as illustrated in the chart below.

**FIGURE G: US Consumer
Purchasing Power
by Gender**



Source: "Buying Power," Catalyst, 2008

While women's shares of the population and consumer buying power are not likely to increase over time at the same levels as those of ethnic minorities, they are surely not expected to decrease in any significant way. Still, one might expect at least a modest increase in women's buying power relative to their population size if they continue to gain greater parity with men in terms of compensation.